

Message Text

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ACTION EB-08

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INFO AMEMBASSY DAR ES SALAAM
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AMEMBASSY LILONGWE
AMCONSUL LUBUMBASHI
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AMEMBASSY MBABANE
AMEMBASSY NAIROBI
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SUBJ: ZAMBIA DEVALUES THE KWACHA

REF: LUSAKA 0867

1. SUMMARY: THE ZAMBIAN DEVALUATION OF THE KWACHA BY TEN PERCENT IS PART OF A PRORRAM TO REDUCE KWACHA LOSSES BEING INCURRED BY THE COPPER MINES. ZAMBIA AND THE IMF NOW HAVE AN AGREEMENT IN PRINCIPLE BY WHICH ZAMBIA WILL RECEIVE STANDBY ASSISTANCE AMOUNTING TO SDR'S 315 MILLION. THE FINANCE MINISTER ALSO ANNOUNCED HER MEASURES TO REDUCE MONETARY EXPANSION. THE DEVALUATION COULD HAVE A NEGATIVE EFFECT BY FURTHER LIMITING NEEDED IMPORTS.

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2. IN ANNOUNCING ZAMBIA'S TEN PERCENT DEVALUATION OF THE KWACHA (REFTEL) GRZ MINISTER OF FINANCE, JOHN MWANAKATWE ALSO SAID ZAMBIA HAD REACHED AN AGREEMENT IN PRINCIPLE WITH THE IMF. THE IMF WILL GIVE ZAMBIA A CREDIT OF 315 MILLION SDS (3390 MILLION); OVER A TWO YEAR STANDBY ARRANGEMENT. OF THIS, FIFTY MILLION SDRS WOULD BE AVAILABLE AS SOON AS THE AGREEMENT

BECOMES EFFECTIVE AND THE REMAINING 250 MILLION WOULD BE DRAWN QUARTERLY OVER THE TWO YEAR PERIOD. THE AGREEMENT WOULD ALSO PROVIDE 49 MILLION SDRS FROM THE COMPENSATORY FINANCE FACILITY AND 49 MILLION SDRS FROM A TRUST FUND. (WE ARE NOT CERTAIN IF THESE AMOUNTS ARE INCLUDED IN THE SDR 315 MILLION OR IN ADDITION.) THE IMF ALSO WILL RESCHEDULE A ZAMBIAN DEBT OF KWACHA 35 MILLION (\$42 MILLION).

3. THE FINANCE MINISTER DESCRIBED THE IMF DEAL AS "UNDOUBTEDLY THE LAST HOPE FOR THE ECONOMIC RECOVERY OF THE COUNTRY." AS PART OF THE AGREEMENT, THE BUDGETARY DEFICIT WOULD BE FURTHER REDUCED IN 1979, LIMITS ON BANK BORROWING BY THE GOVERNMENT AND MINES ESTABLISHED, INTEREST RATES ADJUSTED AND AN INTERIM WAGES AND INCOMES POLICY ADOPTED TO REDUCE MONETARY EXPANSION. PARASTATALS WILL NOT BE ABLE TO DEPEND ON BORROWING BUT WILL BE ALLOWED TO OPERATE ON A COMMERCIAL BASIS. THE IMF PROGRAM INCLUDES A PROGRESSIVE REDUCTION OF PAYMENTS ARREARS AS WELL. PRODUCER PRICES WILL BE REVIEWED ANNUALLY AND ANNOUNCED IN TIME TO ENCOURAGE PRODUCTION AND EXPORT ORIENTED INVESTMENTS WILL BE ENCOURAGED.

4. MWANAKATWE SAID THE TEN PERCENT DEVALUATION WAS PART OF A "MIDDLE COURSE" CHOSEN BY THE GOVERNMENT TO DEAL WITH THE CURRENT ECONOMIC SITUATION, PARTICULARLY THE HUGE LOSSES BEING INCURRED BY THE MINES. IN ORDER TO CUT THE MINES' COMBINED LOSS OF K61 MILLION (\$73 MILLION), MWANAKATWE SAID A DEVALUATION OF LIMITED OFFICIAL USE

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TWENTY PERCENT OR "MASSIVE REDUNDANCIES)" IN THE INDUSTRY WOULD HAVE BEEN NECESSARY. INSTEAD, THE GOVERNMENT DECIDED ON A TEN PERCENT DEVALUATION AND FEWER REDUNDANCIES AIMED AT REDUCING MINE LOSSES TO KWACHA 31 MILLION (\$37 MILLION).

5. THE MINISTER SAID IMPORT PRICES SHOULD NOT GO UP MORE THAN FIVE PERCENT AS A RESULT OF DEVALUATION AND THAT LOSSES ARISING FROM THE DEPRECIATION ON PERSONAL REMITTANCES AND SOME SMALLER ITEMS WOULD BE BORNE BY THE BANK OF ZAMBIA. IT IS UNCLEAR WHETHER OR NOT THE DEVALUATION WOULD APPLY TO ARREARS CURRENTLY IN A FIFTEEN MONTH LONG QUEUE.

6. COMMENT: DESPITE THE OVERALL RELIEF THAT ZAMBIA HAS REACHED AGREEMENT WITH THE IMF, MANY OBSERVERS, THE EMBASSY INCLUDED, ARE STILL CONCERNED ABOUT THE EFFECT OF THE DEVALUATION, MINIMAL THOUGH IT IS. THERE WILL BE KWACHA RELIEF FOR THE MINES BUT THE IMPACT ON IMPORT PRICES IS STILL A BOTHERSOME QUESTION. ZAMBIA'S EXTREMELY HIGH DEPENDENCE ON IMPORTED INPUTS (60 TO 80 PERCENT FOR THE MINES, 30 TO 50 PERCENT FOR MAIZE PRODUCTION, AND 20 TO 40 PERCENT FOR ALL CONSUMER CONSUMPTION) WILL BE STRAINED FURTHER BY AN INCREASE IN THE PRICE OF IMPORTS. IT IS DIFFICULT TO PROJECT WHETHER THE IMF FACILITY WILL BE SUFFICIENT

TO MEET OTHER OBJECTIVES AND PERMIT THE LEVEL OF IMPORTS
NEEDED TO SUSTAIN NORMAL ECONOMIC ACTIVITY.

7. EMBASSY AGAIN REQUESTS DEPARTMENT PROVIDE ANY INFORMATION
AVAILABLE FROM IMF ON RATIONALE FOR THE DEVALUATION. IN ADDITION,
DEPARTMENT REQUESTED TO CONFIRM DETAILS OF IMF/ZAMBIA AGREEMENT.
LOW

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